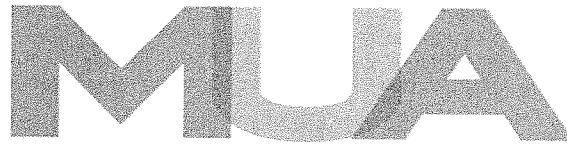


The
Management
University
of Africa



Sponsored by the Kenya Institute of Management

UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

FIN 421 : SECURITY ANALYSIS AND SECURITIZATION

DATE: 5TH APRIL 2017

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

FOCUS OF TRADITIONAL SECURITY ANALYSIS

Traditional security analysis usually takes a "top-down" approach: It begins with economic analysis and then moves to industry analysis and finally to fundamental analysis. Economic analysis is concerned with assessing the general state of the economy and its potential effects on security returns. Industry analysis deals with the industry within which a particular company operates, how the company is measuring up with the major competitors in the industry, and the general outlook for that industry. Fundamental analysis looks in depth at the financial condition and operating results of a specific company and the underlying behavior of its common stock. In essence, it looks at the "fundamentals of the company," that is, the company's investment decisions, the liquidity of its assets, its use of debt, its profit margins and earnings growth and ultimately, it looks at the future prospects of the company and its stock. Fundamental analysis is closely linked to the notion of intrinsic value because it provides the basis for projecting a stock's future cash flows. A key part of this analytical process is company analysis, which takes a close look at the actual financial performance of the company. Such analysis is not meant simply to provide interesting information about how the company has performed in the past, rather, it is done to help investors formulate expectations about the future performance of the company and its stock. Make no mistake about it, in the field of investment, it is the future that matters. But in order to understand the future prospects of the firm, an investor should have a good handle on the company's current conditions and its ability to produce earnings.

The concept of security analysis is general and fundamental analysis in particular is based on the assumption that investors are capable of formulating reliable estimates of a stock's future behavior. Fundamental analysis operates on the broad premise that some securities may be mispriced in the market place at any given point in time. Furthermore, fundamental analysis assumed that, by undertaking a careful analysis of the inherent characteristics of each of the firms in question, it is possible to distinguish those securities that are correctly priced from those that are not. To

many, those two assumptions of fundamental analysis seem reasonable. However, there are others who just do not accept the assumptions of fundamental analysis. These are the so called "Efficient Market" advocates. They believe that the market is so efficient in processing new information that securities trade so close to or exactly at their correct values at all times. Thus, they argue, it is virtually impossible to outperform the market on a consistent basis.

Required:

- a) Differentiate a Blue Chip stock from a Growth Stock (5 Marks)
- b) Clearly show your understanding of random walks 3 and efficient markets 3 highlighting the two (2) key types of random walks 4 according to Harry Markowitz (10 Marks)
- c) Ratios are grouped according to a basic function relevant to financial analysis. Identify and discuss five (5) types of ratios (10 Marks)

QUESTION TWO

- a) Discuss the sources of common stock value (5 Marks)
- b) An analysis of the sales growth record and growth prospects of an industry or a company frequently can be conducted within the frame-work of the so-called industrial life cycle. Clearly critique of the Industrial Life Cycle (10 Marks)

QUESTION THREE

- a) Explain the statement "Sale of common stock at a "premium over book value" traditionally has been an important source of growth for public utility companies" (5 Marks)
- b) Explain the following terminology;
 - i. Current Income (2 Marks)
 - ii. Capital Gains (2 Marks)
 - iii. Expected Return (2 Marks)
 - iv. Time Value of Money (2 Marks)
 - v. Compound Interest (2 Marks)

QUESTION FOUR

- a) Differentiate between Financial Risk and Purchasing Power Risk (5 Marks)
- b) Clearly show your understanding of Common stock as a corporate security and classified common stock (10 Marks)

QUESTION FIVE

- a) Clearly demonstrate your understanding of the term "Market Value" (5 Marks)
- b) Briefly explain an Efficient Market and discuss the three (3) hypothesis of the efficient market (10 Marks)

QUESTION SIX

- a) State ten (10) disadvantages of Average Rate of Return (ARR) (10 Marks)
- b) Briefly explain "Market Segmentation Theory" (5 Marks)